

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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date: August 11, 2006

to: Robert H. Curran  
(Internal Revenue Service, Examination, Senior Tax Analyst)

from: Janice Feldman, Assistant to the Branch Chief  
(CC:PA:APJP:B02)

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subject: Divisibility of I.R.C. Section 6708 Penalty

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

**ISSUE**

Whether penalties assessed pursuant to the current version of section 6708 are divisible for the purposes of establishing refund suit jurisdiction.

**CONCLUSION**

The current section 6708 penalty is a divisible penalty for the purpose of establishing refund suit jurisdiction.

**BACKGROUND**

The Service is developing procedures to use in the assessment and collection of penalties imposed by the current version of section 6708, and a concern arose regarding whether or not a taxpayer must full pay the current section 6708 penalty in order to establish refund suit jurisdiction. As a general rule, a taxpayer can only institute a refund suit in a federal district court or the United States Claims Court if the taxpayer full pays the tax liability prior to the commencement of the suit. Flora v. United States,

362 U.S. 145 (1960). Courts have recognized a limited exception to this so-called "full payment rule" when the taxes are deemed divisible. In that case, the taxpayer need only pay a divisible portion of the tax to satisfy the payment prerequisite to jurisdiction. Thus, you have requested guidance from this office concerning whether the current version of the section 6708 penalty is divisible for the purpose of establishing refund suit jurisdiction. This memorandum responds to your request.

### LAW AND ANALYSIS

To meet the jurisdictional requirements of a refund suit, a taxpayer must generally make full payment of assessed taxes due before the matter may be adjudicated. See Flora, 362 U.S. at 177. In general, the partial payment of assessed taxes or a proposed deficiency is insufficient to support refund suit jurisdiction. Id. The majority opinion in Flora, however, noted that one possible exception to the full payment rule might exist where certain "tax assessments may be divisible into a tax on each transaction or event, so that the full-payment rule would probably require no more than payment of a small amount." Flora, 362 U.S. at 175-78, fn. 38. The Court was referring at that time to excise taxes. The Court's analysis, however, hinged divisibility on a tax being levied on each transaction or event.

Over time a limited exception to the "full payment rule" of Flora has developed with respect to divisible tax assessments. A divisible tax is one that may be divided into separate portions or transactions, and only a portion of the tax must be paid before a claim is filed. See Steele v. United States, 280 F. 2d 89, 91 (8th Cir. 1960); Korobkin v. United States, 988 F.2d 975, 976 (9<sup>th</sup> Cir. 1993).

In Steele v. United States, which involved penalties assessed under section 6672, the Eighth Circuit, noting Flora, adopted the "partial payment rule" holding that a taxpayer assessed a penalty under section 6672 need only pay the divisible amount of the penalty assessment attributable to a single employee's withholding before instituting a refund action. The taxpayer, therefore, only had to pay the withholding tax of one employee for one taxable period in order to establish refund suit jurisdiction. Boynton v. United States, 566 F.2d 50, 52 (5th Cir. 1977). See also Hankin v. United States, 891 F.2d 480 (3<sup>rd</sup> Cir. 1989) (found that section 6700 and 6701 penalties are divisible); Nordbrock v. United States, 173 F.Supp. 2d 959 (D. Ariz. 2000), aff'd 248 F.3d 1172 (9<sup>th</sup> Cir. 2001) (found section 6695(d) tax preparer list penalties are divisible). In sum, divisible assessments are those taxes or penalties that are composed of several independent assessments created by separate transactions. Thus, in order to determine if section 6708 is a divisible penalty, one must determine if the penalty can be divided into separate transactions.

The current version of section 6708 reads as follows:

(a) IMPOSITION OF PENALTY.—

- (1) In General.—If any person who is required to maintain a list under section 6112(a) fails to make such a list available upon written request to the Secretary in accordance with section 6112(b) within 20 business days after the date of such request, such person shall pay a penalty of \$10,000 **for each day** of such failure after such 20<sup>th</sup> day.
- (2) Reasonable Cause Exception.—No penalty shall be imposed by paragraph (1) **with respect to the failure on any day** if such failure is due to reasonable cause.
- (b) PENALTY IN ADDITION TO OTHER PENALTIES.—The penalty imposed by this section shall be in addition to any other penalty provided by law.

[Emphasis added.]

Section 6708(a)(2) states that no penalty will be imposed “with respect to the failure on any day” ... reasonable cause exists. This language indicates that a penalized material advisor may raise a reasonable cause defense as to individual days. The burden to show reasonable cause, however, rests with the material advisor so it will be incumbent upon the material advisor to adequately outline not only the existence of reasonable cause but also the specific day or days to which a reasonable cause defense applies. Thus, this statutory language creates the possibility that reasonable cause can exist on separate and noncontiguous days within a penalized period, and, as such, that each day the penalty is imposed is a separate event or transaction. Thus, the specific language of section 6708(a)(2), which states that reasonable cause is considered each day, strongly supports the conclusion that the current version of the section 6708 penalty can be divided into separate transactions, and is, hence, divisible.

In addition, the language contained in section 6708(a)(2) is unique. Other similar penalties imposed for failure to file or failure to provide do not allow for reasonable cause to be considered on a daily (or other unit of time) basis—either reasonable cause existed on the due date for failure to file or produce, or it did not, and the penalty is so assessed in its entirety, or it is not assessed at all.

For example, section 6651, Failure to File Tax Return or Pay Tax, provides at section 6651(a)(1), in relevant part:

In case of failure...to file any return...on the date prescribed therefor...unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there [is a penalty.]

This language reflects that the subject failure is clearly tied to “the date prescribed therefor” and that the reasonable cause for such a failure must exist as of that date, i.e. the due date of the return. This language does not authorize reasonable cause to be considered on a monthly basis. See Jordan v. Commissioner, T.C. Memo 2005-266 and Estate of Hartell v. Commissioner, T.C. Memo 2004-211, citing Industrial Indemnity v.

Snyder, 41 B.R. 882, 883 (E.D. Wa. 1984) and Photographic Assistance Corporation v. United States, 1998 U.S. Dist. LEXIS 16692 (N.D. Ga. 1998).

Further, section 6698 Failure to File Partnership Return provides in relevant part:

[I]f any partnership required to file a return under section 6031 for any taxable year...fails to file such return at the time prescribed therefore...such partnership shall be liable for a penalty... unless it is shown that such failure is due to reasonable cause.

Once again, the statutory language reflects that the failure is tied to the time prescribed for the filing and that reasonable cause is to be reviewed as of the due date of the return. This language does not authorize reasonable cause to be determined on a monthly basis. Therefore, the unique language of section 6708, which provides that reasonable cause can be examined each day, separates it from other similar penalties which would be characterized as non-divisible because the penalty is imposed with respect to one discreet event. For section 6708 purposes, reasonable cause is not tied to the due date for the requested list.

But this is not the only unique attribute of section 6708. As shown by both of the failure to file examples cited above, each possesses a maximum penalty that can be assessed against the taxpayer. Thus, the taxpayer has a calculable ceiling to which he or she can be subjected. This is true of practically every other penalty contained in the Internal Revenue Code. This is not the case with section 6708, however.

In 2004, Congress specifically eliminated the penalty ceiling associated with section 6708 penalties when it amended the section 6708.<sup>1</sup> According to Senate Report 108-192, the penalty cap was removed as the “present penalties [are] not meaningful” and “promoters [are] refus[ing] to provide requested information” to the Internal Revenue Service. Because Congress enacted a penalty that has the potential for extremely high, unlimited and continuously accruing penalties, it is reasonable to interpret the statute in a manner that provides a reasonable means of obtaining potential relief by an affected material advisor. If the penalty was not considered divisible, difficulty in implementing the full pay rule would result because it would be hard for the material advisor to ascertain and pay the full amount due.

In sum, based on the foregoing, the current section 6708 penalty should be treated as a divisible penalty. Thus, a taxpayer assessed with a penalty under section 6708 need only pay the divisible amount of the penalty attributable to a single day, or \$10,000, before instituting a tax refund suit under section 7422. It should, however, be noted that there is some limited support for the position that the current section 6708 penalty is not divisible. In Christian Laymen in Partnership, Ltd. v. United States, 1989 WL 168769

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<sup>1</sup> The original language of the section 6708 penalty was: “...a penalty of \$50 for each person with respect to whom there is such a failure...the maximum penalty...for any calendar year shall not exceed \$50,000.”

(W.D. Okla. 1989), the Court considered divisibility of the section 6698 failure to file penalty. This penalty was a “failure to file” penalty, with the penalty being assessed upon a partnership’s failure to file its information return. This penalty is a monthly penalty limited to five months, with the monthly amount of the penalty calculated by multiplying \$50 by the number of partners in the partnership. The partnership paid one month’s penalty and filed suit. The Court held it did not have jurisdiction because the section 6698 penalty was not divisible. In so holding, the Court stated that divisible taxes and penalties are those that are viewed as taxes and penalties on separate transactions or events, while the section 6698 penalty was assessed for the failure to file a return, noting: “[t]here is only one failure to file. The penalty is increased for the continuing failure to file, but is not increased as a result of separate acts or transactions.” However, it must be noted that the legislative history of section 6698 made a clear and unambiguous reference to the requirement that section 6698 penalties must be paid in full. The legislative history for section 6708 does not provide any guidance with respect the issue of whether full payment is required. Thus, the holding in Christian Layman should be discounted.

Additionally, the current section 6708 penalty is very similar to a failure to file penalty. The statute expressly provides that the penalty is assessed upon the taxpayer’s failure “to make such list available upon written request.” As has been successfully argued by the United States in the section 6698 context, there can only be one failure to make available, as the Christian Laymen court notes. If this is the case, the penalty accumulates solely due to the continued failure, but is not increased as a result of separate acts or transactions. Thus, one could argue that since there is only one failure involved, the failure to make the list available, the penalty is not divisible. Because this interpretation conflicts with the express language of section 6708(a)(2), which requires that reasonable cause be examined each day, this argument is not compelling.

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